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AMERICAN EXPORTS: WHY HAVE THEY LAGGED?

A STUDY

PREPARED FOR THE USE OF THE

SUBCOMMITTEE ON TRADE, PRODUCTIVITY, AND ECONOMIC GROWTH

OF THE

JOINT ECONOMIC COMMITTEE CONGRESS OF THE UNITED STATES

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LETTER OF TRANSMITTAL

MARCH 29, 1985.

Hon. DAVID R. OBEY,
Chairman, Joint Economic Committee, Congress of the United States, Washington, DC.

DEAR MR. CHAIRMAN: I am pleased to transmit a study entitled "American Exports: Why Have They Lagged?" prepared by Professor Wendell H. McCulloch, Jr., Professor of International Finance at California State University, Long Beach.

The growing U.S. trade deficit is a source of concern to all of us. While the strong U.S. dollar is a key causal factor, it is by no means the only contributing factor. Professor McCulloch has identified 18 obstacles or disincentives to American exports in a study prepared for the Joint Economic Committee's Subcommittee on Trade, Productivity, and Economic Growth.

The McCulloch study is limited to the export side of the trade equation, and in its specialized setting, provides a great deal of historical and background material on factors that depress U.S. exports. The study assigns a 25 percent blame for declining exports on the strong dollar, and examines whether the present international monetary system of floating currency rates is the cause of the dollar's strength. The study concludes that the system is not to blame.

Given worldwide political unrest, oil price shocks, and divergence of major countries' economic policies, a fixed—as opposed to floating—currency exchange rate system could not have been maintained.

The views expressed herein are those of the study author, and are not necessarily those of the Joint Economic Committee or its members.

Sincerely,

DANIEL E. LUNGREN,
Vice Chairman, Subcommittee on Trade, Productivity, and Economic Growth.

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AMERICAN EXPORTS: WHY HAVE THEY LAGGED?

By Wendell H. McCulloch, Jr.*

Introduction

From 1981 through 1983 American exports fell and imports boomed, bringing about massive balance of trade deficits. The main purpose of this study is to examine the causes for the faltering exports. One cause is the strong U.S. dollar which has floated steadily upward in comparative value. There are many other causes for the lagging American exports, which are identified in this study.

Some commentaries on U.S. export difficulties lay most of the blame on the strong dollar; others mention one or two contributing export obstacles or disincentives. This study will identify 18 obstacles and disincentives to American exports and will attempt to put the relative importance of the strong dollar into that context.

As stated above, the dollar "floated steadily upward in comparative value." The present international monetary system is one of modified floating of different currency values in relation to each other. There are those who argue that the dollar would not have become so strong and thus an impediment to U.S. exports if the system had been one of fixed currency values maintained by government intervention or by adherence to a gold standard. A second purpose of this study is to examine the validity of those arguments.

Summary

Eighteen forces which depress American exports are identified. One is the relatively strong dollar; others include world trade volume, recession and recovery, debt crises, import barriers to U.S. goods and services, foreign government procurement practices, foreign government-owned company competition, foreign government export incentives, U.S. Government laws and practices, and American labor and management attitudes and activities.

Factors other than the strong U.S. dollar are cumulatively more depressive on American exports than is the strong dollar. It is impossible to isolate the forces' effects to the extent necessary to assign accurately a percentage of blame to each for inhibiting U.S. exports. With that caveat, it is the estimate of this study that the strong dollar can be blamed for no more than 25 percent of the lag in American exports.

Whatever percentage of blame is assigned to the strong dollar, it is an important factor in reducing American exports. This study examines whether the present international monetary system of

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floating currency rates has caused the dollar's strength. The conclusion is that the system is not to blame.

Given worldwide political unrest, oil price shocks, and divergence of major countries' economic policies, a fixed—as opposed to floating—currency exchange rate system could not have been maintained. The forces which destroyed the Bretton Woods exchange rate system have grown stronger, not abated.

Obstacles and Disincentives to American Exports

This study identifies 18 obstacles and disincentives to American exports. They are:

A strong U.S. dollar,
The international debt crises,
Overall drop in international trade volume in 1981, 1982, and 1983,
Emergence of the United States from the 1980 and 1981 recessions sooner and more vigorously than its trading partners,
Import barriers to U.S. goods and services,
Competition from foreign, government-owned companies,
Foreign government procurement practices,
Low cost foreign government export financing,
Other foreign government interference with free trade,
The United States Foreign Corrupt Practices Act,
The United States-Arab boycott legislation,
U.S. antitrust laws,
U.S. tax laws,
Organization of the U.S. Government trade bureaucracy,
U.S. export licensing policies, delays, and sanctions,
Oil and timber export controls,
Failure to stimulate services exports, and
Attitudes and practices of American labor and management.

Relative U.S. Dollar Strength Since World War II

Since World War II, the dollar has experienced periods of strength and of weakness in terms of exchange rates with other currencies. The first postwar system was called the Bretton Woods System. To understand the relative impact of the dollar on American exports, it is useful to outline some important financial history leading up to the floating exchange rate system.

Bretton Woods to 1971.—In 1944, before the war's end, the Allied Powers convened a meeting in Bretton Woods, NH, to establish the international monetary system for the postwar period. They came to the meetings with a predilection toward a gold anchor for currency values and deep distrust of governments as managers of trade or currency values.

Consequently, they established a gold exchange standard by which gold was enshrined as the central value standard. They then established an international body, the International Monetary Fund (IMF), to supervise the new system, thus keeping national governments at arm's length from its management.

The Bretton Woods System was established as follows. The U.S. dollar was made the keystone currency and its value was set in gold at $35 per ounce. Values of all the other major currencies

were set in terms of the dollar at par values per dollar. Chart 1 illustrates the arrangement. (All charts and tables can be found at the end of the study.)

As a result of the central role of the dollar in the international monetary system, an expression of the economic and political dominance of the United States in the 1940's and 1950's world, the dollar became something of a world currency. It replaced gold as the main central reserve asset of most countries. It came to be used in trade, investment, and currency exchanges even in cases not involving the United States as a trading partner or as a source or place of investment. Large transactions on the foreign exchange markets usually go through dollars even though the dollar is neither the original nor the ultimate currency. For example, a German bank wanting sterling, first would buy dollars with its marks and then buy the sterling with those dollars.

Each member country of the IMF agreed to maintain its currency value in relation to the dollar at the par value (exchange rate) assigned at Bretton Woods, and the United States agreed to buy or sell gold from or to member countries at $35 per ounce. Particularly during the 1960's, a number of countries used dollar surpluses they acquired to buy American gold, and the gold supply of the United States decreased sharply. As shown in Chart 2, the U.S. gold supply shrank from $24.8 billion in 1959 to $12.2 billion in 1971 at $35 per ounce. During the same period, dollars in foreign hands—potential liabilities of the United States—grew from $13.6 billion to $62.2 billion.

The fixed currency exchange rate system worked very well during the late 1940's and throughout the period until about 1970. Currency par values could be changed only with IMF permission and only because of "fundamental" causes which a country could not reasonably correct. Occasionally the IMF did sanction devaluations: for the United Kingdom pound in 1967, French franc in 1958 and 1959, and for the German mark in 1961. Japan maintained its exchange rate at 360 yen to the dollar from 1950 through 1970.

By 1971, the United States had lost over half of its gold, and dollars were accumulating abroad in nonresident hands. (See Chart 2.) In order to preserve what gold it had left, the United States "closed the gold window" on August 15, 1971; in other words, the United States suspended gold sales, and by that action it ended the Bretton Woods fixed exchange rate monetary system.

1971 to 1973.—Naturally, the sudden end of the established monetary system was a shock to the financial and trading world. International financial transactions ceased for several days.

Preservation of its gold was not the only American objective on August 15. The United States felt the dollar had become overvalued, thus hindering American exports. It felt exports were further hindered by tariffs and other obstacles of its trading partner countries. In order to gain bargaining power, the United States imposed a temporary 10 percent tariff surcharge on imports from all its industrial country trading partners, except Canada. As its price for removing the surcharge, the United States demanded a lower value for the dollar under a new fixed exchange rate system and tariff concessions from its trading partners.

After intense negotiations, the United States obtained most of what it wanted. In ceremonies at the Smithsonian Institute in December 1971, agreements were signed which raised the gold price of the dollar—thereby devaluing it—and gave tariff concessions to American products. The Smithsonian agreements also set new par values for the other major currencies in terms of the dollar, but the United States did not agree to resume gold sales.

This new monetary system with the new fixed currency exchange rates staggered on for a few months but could not survive the changed economic and political conditions of the world. Although America was still the largest economy, it was no longer the dominant one; Japan and Western Europe were tough competitors. Their monetary and fiscal policies took on new importance for the world. The Euro currency and Euro bond markets had grown to be huge capital resources outside the controls of governments, and the great amounts of dollars and other currencies in those markets could move in or out of currencies with such speed and in such amounts as to overwhelm government efforts to support currencies at nonmarket levels. By 1973, the Smithsonian rates were ignored.

Between 1971 and 1973, the value of the dollar dropped about 20 percent. This is depicted in Chart 3.

1973 to the Present.—By the end of 1973, the values of all the world's major currencies were floating, determined by market forces, with occasional government intervention.

In the mid-1970's, several European governments began trying to tie the values of their currencies together in an arrangement which came to be called the snake. That attempt at a fixed currency exchange rate system failed, but a new effort is underway called the European Monetary System.

The dollar exchange rate during the 1970–83 period is shown in Chart 3. For inflation adjusted and unadjusted records of the dollar exchange rate, see Chart 4 covering the period 1973–83.

Dollar Exchnage Rates and American Exports

The dollar appreciated in value in terms of most other currencies until the Smithsonian agreement superseded the currency exchange portion of the Bretton Woods System. From that time to the present, the dollar has fluctuated. How American export volume has coincided with dollar value changes will now be examined.

Bretton Woods to 1971.—As noted above, currency exchange rates were said to be fixed until the 1971 to 1973 period when the fixed exchange rate arrangements unraveled. Even during the fixed rate era, changes in the exchange rates of the involved currencies could be made with prior approval of the International Monetary Fund, and there were some changes approved. All approved adjustments were devaluations of the other currencies in terms of the dollar. Thus the dollar appreciated in exchange rate terms slowly but surely from the end of the World War II until 1971. It will be recalled that one of America's complaints in 1971 was that the dollar was overvalued and therefore an obstacle to American exporters.

The record of American merchandise exports during the period 1950 through 1970 is as follows:

[Dollars in billions]

Year:		Year:	
1950	$10.2	1965	$26.5
1955	14.4	1970	42.5
1960	19.7		

1971 to 1980.—From 1971 through the third quarter of 1973, the dollar exchange rate fell by about 18 percent on a trade weighted basis. American exports continued to increase, moving up to $98.3 billion in 1974 and $107.1 billion in 1975.

The dollar exchange rate appreciated about 17 percent from the third quarter of 1973 into the first quarter of 1974, and then fell, with a brief interruption during the third quarter of 1974 until the first quarter of 1975 by some 13 percent. The dollar then recovered that 13 percent by the first quarter of 1976. From that height the dollar moved down, with only brief upticks, by some 23 percent by the second quarter of 1980.

American merchandise exports continued to grow, reaching about $114.7 billion in 1976. They grew some 5 percent in 1977 to $120.8 billion, and in 1980 they reached $224.2 billion.

1981 to 1984.—The dollar then strengthened during 1981. From the third quarter of 1980 to the second quarter of 1982, the dollar rose in value by over 50 percent against the Italian lira and the French franc, by over 30 percent against the German mark and the British pound, by about 10 percent against the Japanese yen and some 7 percent against the Canadian dollar. On a weighted average basis, the U.S. dollar appreciated about 20 percent.

Nevertheless, merchandise exports increased in 1981 to $237.0 billion. There were increases in the exports of agricultural products, capital goods (except automotive), and the "other" products category.

The year 1982 saw a continued increase in the cost of the dollar in terms of other currencies. In that year, American merchandise export value fell for the first time in many years to $211.2 billion, and as the dollar continued upward in 1983, the exports continued downward to $200.5 billion.

From June 1980 until January 24, 1984, the dollar rose 57 percent in value on a trade weighted basis. Over the next 2 months, to the end of March, it lost about 5 percent of the gain, but as the year moved on, a combination of factors caused new dollar strength. Some of the factors were higher interest rates and continuing low inflation in America, labor strikes in Britain and Germany, and rocketing by Iranian and Iraqi planes of ships in the Persian Gulf, which threatened the huge oil flow from the Gulf to the world.

Despite the continuing rise of dollar value during 1984, the value of merchandise exports turned back up. American exports for 1984 grew 8.7 percent to a total of $217.9 billion. For manufactured

goods exports, the 1984 figure was $143.1 billion up from 1983's $132.4 billion, an increase of 8.1 percent.

Illustration.—From 1950 into 1984, the foreign exchange behavior of the dollar and American exports during the same periods can be illustrated as follows:

[In percent]

	Dollar	Exports
Year(s):		
1950–70	+20	+316
1971–73	−18	
1973–74	+17	+131
1974–75	−13	
1975–76	+13	+7
1976–80	−23	+95
1980–81	+11	+5
1981–82	+9	−11
1982–83	+20	−15
1983	+17	−5
1984	+15	+8.7

The above table demonstrates no consistent historic ratio between the dollar's relative strength and American export performance. It is evident there are other forces which affect exports.

Moreover, it is commonly believed that export volume results of currency value changes should begin and end with some timelags, and this study touches upon that subject below. But the 1976–80 period of dollar weakness exhibited little or no lag, and American exports increased in 1984 despite the fact that the era of dollar strength which began in 1980 had not ended.

However, one of the two biggest post-World War II fluctuations of the dollar began in 1976 and lasted until 1980 with the dollar losing 23 percent in exchange value. That is about 25 percent of the 95 percent export increase in the 1976–80 period.

The second of the two biggest post-World War II fluctuations began in 1980, and through 1984, there was a net drop in American exports of 18 percent while the dollar rose 72 percent so that exports fell 25 percent as much as the currency rose.

In other words, during the period of sustained dollar decline, the percentage of decline was about 25 percent of the percentage of export growth. During the period of sustained dollar appreciation, the net export drop to the present time is about 25 percent of the percentage of dollar appreciation.

Evidence is insufficient to state categorically that export volume changes are 25 percent caused by dollar value changes. In the first place, there are only two post-World War II sustained periods of dollar weakness and dollar strength, and the latter period is still underway.

However, given the number of forces other than dollar values which affect exports, it is not unreasonable to assign 25 percent as the dollar value effect on American exports, and to examine some of the other forces. One of them alone, the international debt crisis,

is thought to be the cause of as much as 25 percent of the lag in American exports.

International Debt Crises

The growth of world trade which had been stopped by recession in 1981, was dealt further blows by the debt crises of a number of countries beginning with Poland in 1981 and Mexico in 1982. The biggest—but by no means the only—problem debts for American banks and suppliers are in Latin America with Mexico, Brazil, Argentina, and Venezuela at the top of the list.

These, and all the debt-problem countries, are developing, industrializing nations. They must have capital and capital goods to continue their development and growth, and the United States has been a major supplier of both. Their abilities to import the needed capital goods and technology from the United States depend upon available financing. However, due to the size of their existing debt burdens, banks, suppliers, and governments are reluctant to lend them more money. Therefore, those countries have curtailed their purchases from America drastically.

As the debtor countries were unable to acquire the same levels of financing from abroad, they embarked on austerity programs of varying severity. Some programs were largely self-imposed while others were more the results of pressures from the International Monetary Fund and the creditor banks. A major objective of all the programs is to earn a balance of payments (BOP) surplus to be used to repay debts.

American exporters were thus dealt a double blow. Purchases from them were curtailed as part of the BOP surplus campaign. But then, when the surplus was achieved, it was to be used to repay bank loans, not to buy American goods or services.

The inability of those countries to finance previous levels of imports was the reason for the 50 percent drop in American exports to Mexico from 1981 to 1983, from $18 billion to $9 billion, about one-half in 1982 and one-half in 1983. American shipments to all Latin American customers were off one-fourth in 1983, while exports to developing countries as a group were down about 12.5 percent. Financial problems in Eastern Europe were reflected in a $1½ billion decline in exports to that region in 1983.

The U.S. Treasury has made an estimate of the debt-related part of the American trade deficit. For 1981–83, their figures are "at least $25 to $30 billion." Thirty billion would be 25 percent of the trade deficits over those 3 years. This study has estimated the strong dollar to be about 25 percent of the cause for the lag in American exports. The Treasury figures would indicate the international debt crises to be an approximately equal cause.

Chart 5 illustrates 1983 American merchandise trade balance. It gives information by area and by category.

Another aspect of the effects of the developing countries' debt problems on American exports must be recognized even though one cannot quantify it. The United States was, and is, not the only industrial and industrializing country exporting to the debtor countries. Quite surely their debt repayment problems have lowered their purchases from their other suppliers—not just from the

United States—and almost certainly that has had a further, though indirect, negative effect on American exports.

Table 1 shows the shifts in American trade by country or country group between 1981 and 1983. The largest percentage export drop is to Mexico while the largest volume drop in dollars is to industrial countries other than Japan and Canada.

Overall Drop in International Trade Volume in 1981, 1982, and 1983

From the end of World War II until 1981, world trade grew at a rate faster than that of world production, tying nations more closely together and promoting increasing specialization. When the overall trade of the world was growing, it was relatively easy for American exporters to share the growth even though the U.S. share of world trade shrank as Western European countries, Japan, and the newly industrializing countries emerged as stiff competitors with new plants and improving technology. Then, the recession which began in 1980 throughout the world put a stop to trade growth. American exporters were affected adversely as were most businesses worldwide.

In 1984, the volume of world trade began to grow again. American exports also began to grow again in 1984.

Emergence From Recession

Detrimental from the point of view of American exports is the fact that the United States has recovered sooner and more vigorously from the 1980–82 recession than have its trading partners. Sluggish growth in Europe and Japan has moderated their demands for American goods and services.

In the United States, the trough of the last recession came in late 1982. During 1983, real GNP of America grew by 6.2 percent, fourth quarter to fourth quarter, which was a strong rebound. In contrast, real growth in other major industrial countries was only 3 percent during 1983, and it is not clear, even in the fourth quarter of 1984, that a sustained upturn is yet underway in those countries.

Thus, while a strong recovery persists in the United States, economic expansion in the other major industrial countries in 1984 is not expected to exceed 1983's 3 percent rate. By contrast, real growth of the American economy in 1984 was 5.6 percent on a fourth quarter to fourth quarter basis.

The earlier and faster American economic growth in comparison with other industrialized countries has led and is leading to rapid American import increases. The same growth differences are impeding U.S. exports to those major markets. The Treasury refers to this as a "growth gap" and estimates that it enlarged the U.S. trade deficit in 1984 by some $15 to $20 billion.

In 1983, exports to Western Europe fell by 6.8 percent, and the American trade surplus with Europe fell from almost $8 billion in 1982 to less than $1 billion. Exports to Japan actually grew slightly in 1983, by 4.4 percent, and exports to Canada increased 13 percent. (See Chart 5.) The higher sales to Canada and Japan were not enough to offset the decline of exports to other countries.

Import Barriers to U.S. Goods and Services

After World War II, the General Agreement on Tariffs and Trade (GATT) evolved as an organization to limit tariffs on particular items to the amount negotiated and specified in its tariff schedule and to prevent evasion of the tariff obligation by use of other, nontariff barriers. One type of barrier with which GATT has not dealt is collusion among domestic producers to bar import competition.

Merchandise.—Under GATT auspices, several rounds of trade negotiations have taken place, notably the Dillon, Kennedy, and Tokyo Rounds. By the mid-1960's, tariffs on industrial goods had been reduced by an average of one-third. The Tokyo Round which ended in 1979 further reduced tariffs and broke new ground with agreement on international rules governing nontariff barriers such as discriminatory government procurement and customs valuation.

American exports have grown over the years of tariff and quota reductions under GATT agreements. At the same time, most of the world's economies and their populations have grown, new technologies have proliferated and communications and transportation have greatly improved. The point is that, while lower tariffs and quotas have undoubtedly encouraged trade, many other factors have played extremely important parts, and there is no formula to measure accurately how much trade was added by each factor.

On the negative side of the trade barrier subject, many new and different barriers have arisen, and they have multiplied during the recession which began in 1980. The many countries with debt servicing problems are under particular pressures to limit their imports. One trade area which is experiencing new barriers is the services.

Services.—Services include tourism, banking, insurance, accounting, law, and shipping. A fast growing service area is electronic data processing including transborder data flow.

In tourism, most airlines, railroads, and bus services outside the United States are government owned. Private foreign hotel chains do operate internationally and some private American airlines fly abroad.

In banking, the New York superintendent of banks commented to a congressional committee that he would find it "highly unlikely that the banking authorities of any major country * * * would permit one of their largest banks to be acquired by a foreign interest." He had a recent turndown by the Bank of England as an example.

As for insurance, the market is fragmented. West Germany forbids any insurance business (save marine) to be placed abroad; insurance cannot be imported into France, and Belgium permits only nonmarine business with a premium below $1½ million to be placed abroad.

Accounting and law are strictly regulated by each country. It is not easy for foreigners to practice.

Many countries insist that all coastal and internal shipping be done by national fleets. International trade between industrial countries is strongly influenced by cartels, called conferences.

Services are of great importance to the United States; they are one of the few trade areas in which the United States has a sur-

plus, and this country is becoming more and more a services based economy. Other countries are making inroads and limiting activities of American companies. One of the frontiers in the services area is the processing and transfer of information, and countries are studying the pros and cons of controls on transborder transfer of information.

Domestic Business Bars to Import Competition.—It has been called "An Invisible Japanese Trade Barrier" and results from weak enforcement of Japanese antitrust laws by its Fair Trade Commission (FTC). Japanese soda ash producers told their customers that if they bought imported rather than Japanese soda ash, the customers would not be permitted to buy the Japanese product if foreign supplies became unavailable any time in the future.

Japanese customers, therefore, feared to buy American soda ash, and American producers complained to the State Department. The U.S. Embassy asked the FTC to act and it did order the Japanese companies to relax their hold on the soda ash market including the silos in which the ash is stored.

However, the FTC did not charge the Japanese companies under the section of the Japanese Antimonopoly Act which makes their refusals to deal and threats of refusal illegal. The Japanese companies are thus free to continue monopolizing the Japanese market by those methods. The Japanese synthetic rubber manufacturers are engaging in the same practices.

Competition From Foreign, Government-Owned Companies

Outside the United States, governments own the bulk of the oil industry and most of the airlines; Western European steel industry is mostly nationalized. State-owned companies which were taken over or developed in the 1970's are in aerospace, aluminum, shipbuilding, automaking, pharmaceuticals, electronics, computers, office equipment, petrochemicals, and telecommunications. West Germany, supposedly a free market country, has stock in more than 600 companies. In France, the Socialist Government, elected in 1981, took over steel and five other key industrial groups. The same pattern of government ownership has spread to the Third World, the developing and less developed countries.

Dealing or competing with state-owned companies is a growing problems for privately owned companies. This was recognized in the World Bank's World Development Report of 1983, which makes some observations about the often unwieldy government-owned enterprises.

A state-owned company does not have to be efficient or profitable. It can sell below cost because it gets government—taxpayer—subsidies. Its goals are to keep its workers employed, gain influence within its government, capture strategic markets, acquire hard currency, or gain political clout for its managers.

Such companies can, and frequently do, compete unfairly with America's privately owned firms. With no need to earn profits, state-owned firms can underbid private competitors.

Complaints have been made about the predatory pricing practices of government-owned British Steel, and the U.S. International Trade Commisson has found damage to American specialty steel

companies by state-owned or financed steel producers in West Germany, France, Sweden, and Spain, Boeing has accused Airbus Industrie, a consortium of state-owned companies, of unfair competition.

The American countervailing duty laws can help protect American producers against subsidized imports into the United States, but proving subsidization can be difficult when the foreign company is government owned and less subject to market forces in its price setting in home and third country markets. And, of course, the American countervailing duty laws are of no help to American exporters when they compete abroad against the nationalized enterprises.

Foreign Government Procurement Practices

Governments are huge consumers and therefore potentially excellent customers for businesses. And governments, spending taxpayers' money, should purchase from the most efficient, least expensive sources. But they don't; not, at least, if those sources are foreign.

In spite of a GATT procurement agreement reached in the Tokyo Round and a European Community (EC) supplies directive of 1978 which require public bidding for most government contracts, open to bidders from any country, the EC governments favor their own, home companies. American computer and office equipment companies have complained that their British rival, ICL, is winning public-sector contracts in Britain on national rather than technical or economic grounds. The German and French Governments scarcely bother to advertise when they are buying.

Japan has been the target of many complaints about its closed Government procurement policies. In 1982, American tobacco makers obtained a document of the Japan Tobacco & Salt Corporation which is government-owned and which monopolizes the Japanese tobacco market. Although the Japanese Government had said it was "doing everything possible" to open its big tobacco market to foreign companies, the leaked document is a battle plan of how to squelch foreign cigarette sales in Japan.

In 1983, Japan cut its tariff on imported cigarettes, and increased the number of tobacco shops permitted to handle foreign brands from 20,000 to some 70,000 out of an estimated 250,000 shops. Despite these liberalizations, growth of the import share of the Japanese cigarette market has been extremely slow, about one-tenth of 1 percent per year. Imported cigarettes now have about 2 percent of the Japanese market compared to 25 to 35 percent of the European market.

Tobacco is only one of many products bought or controlled by the Japanese Government. The Nippon Telephone and Telegraph Company (NTT) is another government monopoly to which no foreign firms could sell. Recently, promises have been made and steps have been taken to give foreign firms some access to sell to that monopoly. One step has been the enlargement of a NTT office in New York to encourage and help American suppliers sell to the monopoly.

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NTT is to be privatized but no shares will be sold to foreigners. The Economist noted that privatization offers Japan an opportunity to open its market for importers, but the article commented, "The Japanese look like muffing it."

Only $140 million of $2½ billion purchased by NTT in 1984 came from abroad. For the future, an "independent" testing organization will choose equipment for NTT purchases, but the new organization is being staffed by the big Japanese telecoms makers—NTT's current suppliers—and by NTT personnel.

A general complaint about Japanese procurement procedures was that made by a Commerce Department official in December 1984 that Japanese Government agencies invite bids from only a single supplier. The suggestion was that competition should be open to all potential bidders, including foreigners.

Low-Cost Foreign Government Export Financing

The governments of all industrial, exporting countries have agencies which finance or guarantee financing of exports. The purpose is to encourage exports, and therefore the finance terms are better than those available in the market; interest rates are lower and/or payment times are longer. There is frequent competition among these agencies, and American exporters often complain that other governments do more than does the United States to help their exporters.

More than 30 percent of exports from Britain, France, and Japan are backed by government loans, compared with about 6½ percent of U.S. exports. Furthermore, interest rates charged by the foreign agencies have generally been 2 to 3 percentage points lower than those charged by the American Export-Import Bank. There have been so-called "gentlemen's agreements" between the agencies setting minimum interest rates, but the agencies of other countries frequently ignore the agreements when an important export contract is at stake.

Other Foreign Government Interference With Free Trade

A member of the Joint Economic Committee has written:

> Most troublesome, however, is the growing use of unfair trade practices by countries attempting to capture an undue share of world markets. Such begger-thy-neighbor practices unjustly deny the United States expanded export and job opportunities; * * * foreign markets are far from open, and trade continues to be constrained by government actions. These actions, aimed at the achievement of domestic economic objectives, serve to prevent the United States and other competitors from gaining an equitable share of the global purchasing pie. One of the most distortive examples of government involvement in trade is the use of subsidies designed to capture foreign markets. Direct export subsidies, such as those provided by the European Community to spur overseas sales of agriculture products, have displaced U.S. producers in third markets, leading to job losses at home. Officially supported export credits * * * have crippled U.S. efforts to compete fairly for contracts on a wide range of products.

Governments utilize countless devices to limit or prevent imports. The devices usually do not discriminate against American goods, as such, but are protectionist measures for domestic industries. We can name a few of the devices.

All literature about the product must be translated into the local language. Packaging must be of specified and different material,

shape, or size. Each unit of the product must be tested in the importing country to determine conformance with safety, health, or other regulations. The product is permitted entry to the country only at one location which has very limited customs, warehouse, storage, or transportation facilities.

The customs services themselves can be obstacles. They may classify the product to put it in a high-tariff category; even though they may be incorrect, it could take months and great expense to appeal the customs rulings. Customs can be very slow or can lose the paper. The customs officials may want bribes for expedited, favorable action, and such payments could break local and American law.

Foreign Corrupt Practices Act (FCPA)

Thus far the study has dealt with international or foreign obstacles and disincentives to American exports. It turns now to some impediments within or caused by the United States.

Statements from a wide variety of U.S. Government officials decry and express deep concern about the very large American trade deficits. They all recognize that one way to reduce or end the deficits is to increase American exports. It should follow from those concerns that American Government laws and practices are designed and carried out to encourage and maximize American exports. Astonishing as it may be, they are not, and, in fact, there are several laws and government practices which impede exports by American firms.

A list of such laws and practices, not necessarily in order of the magnitude of their effects on exports which would be difficult to measure, would include: The Foreign Corrupt Practices Act, the Arab Boycott legislation, the antitrust laws and regulations, the tax laws and regulations, the organization of the government's trade bureaucracy, export controls, and failure to stimulate services exports.

During the 1970's, revelations of "questionable" or "dubious" payments by American companies to foreign officials in order to get export contracts, rocked governments in Japan and the Netherlands. Congress called such payments "bad business," and the President termed them "ethically repugnant." In reaction, the FCPA was passed and signed.

The FCPA makes most, but not all, such payments illegal in the United States even though they may break no law where paid. There are a number of uncertainties under the FCPA, such as exactly what payments are permitted. To further confuse this issue, U.S. Justice Department officials have suggested they may prosecute a firm which made a payment permitted by FCPA, because it constituted a bribe under other statutes written to get at corruption in the United States.

From an export competitiveness point of view, the worst thing about FCPA is that no other country has such a law. Thus every foreign competitor of American exporters is legally free to make whatever payments are necessary to get a particular order. It is widely recognized that bribery is an accepted way of life in many countries. Not so widely known is the fact that payments to get ex-

port contracts are specifically tax deductible in at least two Western European countries, no questions asked.

In a Business Week/Harris Poll in 1983, 78 percent of the American business executives polled replied that FCPA makes it difficult to sell abroad and hurts exports. Particularly hard hit are American makers of heavy electrical equipment, electrical components, and consumer electronic products and components.

Arab Boycott Legislation

As part of the hostilities and wars between Arab countries and Israel, several of the Arab nations boycott companies which do business with Israel. The Arab countries will not buy from such companies if they can procure the product elsewhere. Inasmuch as several Arab countries are rich oil producers, they are very large markets.

In 1977, the Congress passed a law forbidding American companies from participation in the Arab boycott. Under this legislation, enforced by the U.S. Department of Commerce, an American company must report, but cannot respond to, any questions from Arab sources about the company's relations with Israel. Enforcement of the law has toughened, and in 1983, Citibank paid a record $323,000 fine for failure to report promptly some letters of credit which contained anti-Israel provisions.

As in the FCPA case, no other country has any sort of Arab boycott law. A Chase Manhattan Bank study said, "Undoubtedly American export sales are being lost." A trade adviser at the U.S. interest section in Baghdad, Iraq, estimated America could have sold at least $3.5 billion in Iraq in 1980, rather than the $725 million which was booked.

Antitrust Laws

An aspect of the U.S. antitrust laws which impedes exports is the rule which prevents American companies from teaming up to bid on big projects abroad. Such restrictions on cooperation abroad were cited as the worst obstacles to exports caused by American antitrust laws in a National Association of Manufacturers study. Seventy percent of the over 100 companies surveyed said U.S. antitrust laws and practices caused a decline in their international competitiveness.

Some relief from antitrust burdens on American exporters was given by the Export Trading Company Act of 1982. Its centerpiece is its limitation of applicability of antitrust law to foreign trade which was also the key bone of contention in the drawn-out legislative battle fought to enact the measure. As with most compromises, the result contains ambiguities, but the result will probably improve the antitrust situation for American exporters.

Tax Laws

The American Internal Revenue Code is probably the most complex tax system in the world. That alone is a heavier burden for American business than is borne by its foreign competition.

In addition, the United States is the only country to tax its citizens on a national rather than a territorial basis. Americans, even though they live and work outside the United States, must file U.S. tax returns. It is true that such persons have an exclusion of a maximum amount of their earned income (e.g., salaries, commissions, or bonuses). However, there is no exclusion of any so-called unearned income (e.g., dividends, interest, or royalties). And, even if they owe no U.S. tax, such persons must file U.S. returns. That is in addition to the returns which must be filed under the laws of the countries where they live and work.

All this discourages Americans from taking jobs abroad. A study by Chase Econometrics shows that American exports suffer when American managers abroad are replaced by foreigners.

The U.S. Government Trade Bureaucracy

As was stated in the 1984 Joint Economic Report, "Trade leadership is now split between the Department of Commerce and the U.S. Trade Representative." It was pointed out that such a split is in many respects artificial and "results in management inefficiencies, turf battles, and ad hoc, reactive and sometimes contradictory government trade policies."

The Report goes on to recommend restructuring the American organization for trade. A solution would be the Administration-proposed Department of International Trade and Industry.

U.S. Export Licensing Policies, Delays, and Sanctions

Even before the Soviet invasion of Afghanistan in December 1979, American business knew about the need for validated export licenses. They were filing some 300 detailed applications each working day during 1979 at the Commerce Department's Office of Export Administration for export licenses for strategic materials or for shipments to Communist countries.

It could take months for a sale to the Soviet Union to win approval—even if the cargo was a microprocessor costing $15, that a Russian embassy official in Washington could buy from the local Radio Shack. Customers for American goods lose patience and buy what they want from Europe and Japan. American firms are complaining that the rules are too strict and the processing time too slow.

Sanctions are imposed on shipments of strategic goods to certain countries such as the Soviet Union, Cuba, and Vietnam. For a time after the Afghanistan invasion, sanctions were placed on wheat shipments to the Soviet Union.

Oil and Timber Export Controls

Oil produced in Alaska is, in effect, totally restricted by U.S. law from export to Japan. The Japanese must procure their oil from other, more distant sources.

Logs cut on U.S. Government land are banned by American law from export to Japan. As with oil, the Japanese import most of the timber they use, and the export earnings potential for America is very large.

Failure To Stimulate Services Exports

As indicated above, the United States enjoys a surplus in services trade, but that is in spite of, not because of U.S. Government policies. National policy should promote the vitality of American services in world markets. Instead, it favors manufacturing. Some examples of that are:

Fifteen priority sectors are allotted 80 percent of the Commerce Department's export promotion budget. Not one is a service.

The Export-Import Bank devotes very little of its funds to services. In the 1980–82 period, only about 8 percent of Ex-Im's loans financed service exports.

Manufacturers receive investment tax credits and accelerated depreciation schedules. No such tax favors assist services.

Research and development tax credit is available to manufacturers but not to services.

The dangers of neglecting and not encouraging American service providers are of two kinds: First, foreign governments are creating new and tougher obstacles to American service exports; and second, foreign governments have launched campaigns to persuade service firms to relocate outside the United States, and the blending of new technologies in the computer and telecommunications industries enables much of service production to be moved virtually at will to many places in the world.

Attitudes and Practices of American Labor and Management

From June 1977 until 1980, the U.S. dollar fell in value. This should have helped American exporters and damaged competing exporters. Nevertheless, Germany and Japan kept their exports growing by slashing profit margins or going into the red to maintain market positions.

The rising deutsche mark and yen did cause German and Japanese automobile makers to mark up their dollar prices. American makers took only partial advantage of this price opportunity to enlarge their share of the U.S. market or to export more units. Instead of keeping their prices down and selling aggressively both in America and abroad, the U.S. car companies raised their prices.

The Economist, reporting on the reaction of American industry to the weak dollar, had the following to say: "At home, industries have stuck up prices as imports lose market share and have *started to ponder, still diffidently, becoming exporters themselves.*" (The italic was added for emphasis by this study.) This shows the indifference of much of American business to the export opportunities offered by the weak dollar.

A similar point was made by Paul McCracken in the October 19, 1978, Wall Street Journal. He stated, "While exchange rate adjustments have opened up to U.S. businesses profitable export opportunities, their organizing themselves to develop this potential continues at a slow pace."

Management of American companies have been referred to as "technically illiterate and out of touch" with the world outside the United States and as indifferent to export expansion opportunities.

One writer in Thailand says American firms "handcuff themselves in the Far East."

An American who has worked for Japanese companies some 10 years speaks of the "naivete" of Americans when they attempt selling to Japanese companies. He says the most common mistake Americans make when trying to sell to Japanese is the "shove it down their throats" syndrome.

A Japanese buying mission in the United States in 1984 encountered two types of problems. One was to find American products to suit Japanese tastes and distribution systems. The second was to get American business export cooperation. The mission leader was "shocked" when three American firms turned down orders she gave them "because exporting is too much trouble."

A Business Week article entitled "The Reluctant Exporter" speaks of management and labor attitudes toward international competition. One sentence says, "The response of labor unions, Congress and many industries to deteriorating U.S. trade competitiveness has been to demand restrictions on import rather than stepped-up efforts to boost sales of U.S. products abroad."

The U.S. dollar was weak from 1977 into 1980. That weakness should have helped the American merchandise trade balance move into or close to surplus. That did not occur, and in 1981 the deficit grew to $27.82 billion from 1980's $25.34 billion.

So, despite the weak dollar, the United States never neared a merchandise trade balance when agriculture and petroleum are included. One reason for this was the apparent lack of effort by American firms to capitalize on the cheap dollar and go for exports. Another reason was the profit cutting and losses endured by foreign suppliers in order to retain their market share. And they were helped in that effort by American business which was content to raise its prices rather than capture more of the domestic—not to mention export—market from their foreign competitors.

Despite the growing American merchandise trade deficit, American labor costs in manufacturing are still the highest in the industrial world. This must reduce American industry competitiveness in the world.

By contrast, growth in real Japanese wages has been low in the past few years. After falling by 1.6 percent in 1980, real wages in Japan rose by just 0.4 percent in 1981, 1.7 percent in 1982, and about 2 percent in 1983.

The Organization for Economic Cooperation and Development forcasts that unit labor costs in manufacturing would fall in Japan by three-fourths percent in 1984 while rising by 3½ percent in Britain, 1¼ percent in the United States, and one-half percent in Germany. Partly as a result of this, Americans and Europeans should not expect that a stronger yen will soon give them a breather from Japanese competition. Wage increases in 1984 are between 3 percent and 5¼ percent, inflation is low and productivity is rising in Japan.

Conclusions

The relatively strong U.S. dollar is not the major cause of lagging American exports. It is an important cause, but other obsta-

cles and disincentives have cumulatively much more depressing effects on exports. One of them alone, the international debt crisis, is estimated to be as important a cause of lower exports as the strong dollar.

No attempt is made to measure the relative depressive effects of the other 16 obstacles and disincentives identified in this study. The truth is that efforts to assign percentage numbers to any of them are something of a waste of time.

Much more productive is the recognition of the obstacles and disincentives in order that steps may be taken to overcome and correct them. Those attributable to foreign governments should be addressed by the U.S. Government through bilateral negotiations or through GATT procedures. Those caused by the American government can be corrected by it. Last, the attitudes and practices of American labor and management can be improved by education both during and after the years of formal schooling.

Effects on American Exports of the International Monetary System

Whatever percentage is accorded to the relative importance of the dollar's exchange rate to U.S. exports, there can be no doubt it is a major factor.[1] Is the current international monetary system of modified floating currencies best for encouragement of American exports or would other systems serve better? [2]

Fixed Exchange Rates

There is considerable sentiment in the world for a "dependable" system wherein rates of exchange are fixed and people know how many units of foreign currency can be bought by their own money. European leaders have called for "a return to Bretton Woods," referring to the fixed rate system established at Bretton Woods near the end of World War II.

The European Monetary System (EMS) is an example of an attempt by several important countries to return to a fixed rate system. As such, it is instructive to measure how it is working.

EMS is an expression of the desire of its members to tie their currencies' values to each other. Since EMS's inception in 1979 there have been a number of value realignments of members' currencies, and more will be necessary unless fundamental changes are made in the EMS agreement.

Each member of EMS continues to control its own economic policies. Each tailors its fiscal and monetary policies with a primary eye on domestic political and economic forces. Thus, while some countries are directing restrictive measures to cool the economy and combat inflation, others are running expansionist policies to reduce unemployment or rescue obsolete industries.

So long as such divergent policies are being implemented, there can be no long-term maintenance of fixed currency exchange rates.

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[1] See Appendix 1 for a discussion of reasons for the dollar's strength—reasons unique to the dollar—continuing impact of the strength, deindustrialization of America due to the strength, export and other impacts of a weakening dollar, and merchandise and current account balances.

[2] See Appendix 2 for additional discussion of fixed and floating systems, foreign exchange markets, sizes of and reasons for exchange rate fluctuations.

Inflation in one country, slower inflation in a second, and deflation in a third must result in lower prices in the third than in the second, and still higher prices in the first. Exchange rates realistically reflecting those differences would see devaluation in the first, less devaluation in the second, and no change or up valuation in the third country.

Different interest rates in the several countries resulting from different economic policies would affect relative currency values. Of course, interests rates are not unrelated to inflation.

Unless EMS members are willing to surrender control of their economies to some super-national body, or, at least, faithfully observe agreements to closely coordinate their economic policies, EMS currency rates will continue to fluctuate. In reality, it is not a successful fixed rate system.

Defenders of EMS point out that members' currency value fluctuations have moderated since they joined the group. Even so, most would agree there can be no true fixed rate system without economic policy coordination which would require members to surrender much of their sovereignty.

The problems of a fixed rate system, demonstrated by the EMS, would be multiplied many times if an attempt were made to fix all the major currencies' rates. The most economically important countries not now EMS members are the United States, Japan, the United Kingdom, Canada, Australia, and South Africa. None of the developing or poorer countries are members, nor are there any Communist country members.

Efforts of nations to keep their currencies at nonmarket exchange rates are overwhelmed by the huge amounts of moneys in the hands of banks, businesses, individuals, and other governments. Those amounts continue to grow.

The fixed rate systems of the post-World War II era have depended upon intervention by member governments in the foreign exchange markets to prevent their currencies from rising or falling more than a prescribed percentage above or below the fixed rate. One reason a worldwide fixed rate system is unlikely to be successful is that the immense amounts of currencies in nongovernment hands will be traded to reach market-clearing value relationships. When governments try to establish or maintain nonmarket values, which history indicates inevitable, the government reserves are not enough to resist the volume of privately held currencies.

Another reason a successful worldwide fixed exchange rate system is improbable is the necessity that the member countries either agree to be bound by the same fiscal and monetary policies or surrender power over those policies to a super-national agency Such surrender of national sovereignty is difficult to envisage in the near future.

Floating Exchange Rates

The present floating system—partially changed in 1979 by the EMS discussed above—fell into place in 1973. It was not established; it simply occurred by default because countries had lost the power to keep their currencies at government-set values. As a German central bank official commented, too much money—primarily

dollars but also deutsche marks, francs, yen, and pounds—was controlled by banks, businesses and others more concerned with what they judged to be the real, relative currency values, regardless of how much governments said they were worth.

Economists and government officials were fearful that floating rates would damage international trade and investment. In the event, both trade and investment grew steadily during the 1970's. Traders, and to a lesser extent investors, could, and did, hedge against currency fluctuation risks.

Given the political and economic shocks of the 1970's it seems impossible that a fixed currency exchange system could have endured. Petroleum prices soared. There were petroleum and other embargoes. There were wars and revolutions. There were degrees of inflation ranging from fairly low to over 1000 percent per year. Interest rates rose and fell dramatically. Prices of commodities fluctuated in wide ranges; the price of an ounce of gold went from $35 to $850 and back down to around $300.

In summary, floating rates were inevitable even though many economists and officials disliked and feared them. Although they can be affected to small degrees by government market interventions, floating rates cannot be avoided unless governments become willing to give up control of their economies to a super-national authority or to thoroughly coordinate their economic policies by observed agreements.

The strong dollar is a cause of concern in the United States and other countries. The United States and other countries have intervened in currency markets since 1982 to stem or slow the dollar value rise. The interventions failed—except perhaps temporarily—and as this study is being written in the first quarter of 1985, news headlines are still reporting "The Booming Buck," "Dollar Keeps Gaining," "Dollar Set Records," and others with the same message.

Government intervention in currency markets has been ineffective since at least the early 1970's. There is growing feeling that a new-old solution should be tried, the gold standard.

Gold Standard

One of the greatest merits of the gold standard is said to be the discipline it imposes on politicians. The discipline results from one feature of the gold standard which limits the country's money supply to a multiple of its gold holdings. Thus, the money supply cannot be increased unless more gold is acquired, and if gold is lost, the money supply must be contracted accordingly.

Another gold standard feature is that the value of the currency of each country on the standard is established at some number of currency units per ounce (or other measure) of gold. It could be the U.S. dollar, 400 per ounce; deutsche mark, 1,000 per ounce; yen, 80,000 per ounce, and so forth. The exchange rates of the currencies follow from the number of units per ounce.

One more element of a gold standard is that each country agrees to buy or sell gold at the rate of 1 ounce per the established number of currency units. A country running a BOP deficit with units of its currency going abroad, could expect at least some of them to be presented for its gold. As its gold supply dwindles, it must re-

duce its money supply which is deflationary and should cause lower goods and services prices.

As the BOP surplus trading partner gets gold from the deficit country, its money supply will expand—which is inflationary. That should result in more costly goods and services.

As these processes continue, the goods and services of the BOP deficit country become more competitive and exports grow. The opposite occurs in the surplus country and they trade places. The currency begins to flow to the former deficit country which uses some of it to repurchase gold.

So, in theory, the system is self-regulating. No government action—except to follow the gold standard rules—is called for.

As can be seen, the gold standard takes over the monetary policy functions of governments, which many would resist. How divergent fiscal policies from country to country while on a gold standard would affect the standard's success is possibly worth a separate study. Among other things, differences could affect relative productivity and proclivities to export.

One question raised about the gold standard is the price of gold to be chosen. The $400 per ounce, used above, is a price which has been suggested.

Opponents have pointed out that the Soviet Union and South Africa are big gold producers. In addition to political unpopularity of those countries in some circles, there is concern expressed that one or the other might attempt to disrupt or profit from the gold standard.

A potential danger for the United States adopting the gold standard at the present time with an immense BOP deficit adding to the billions of dollars already held by nonresidents, would be deflation. If foreign dollars holders turn them in for gold, the rules would require the United States to surrender the gold. As the American gold supply shrank, the money supply must contract. A sudden end to American money supply growth, not to mention a falling money supply, could cause deflation, recession, and unemployment.

Further problems of implementation of a successful gold standard involve distribution of gold stocks among nations. Questions about the Soviet Union and South Africa are mentioned above. What countries would join the United States on the standard? How would their observance of the rules be monitored or enforced?

While gold standard proponents may be correct that it would cause lower inflation and interest rates plus money value assurance and discipline, it is not a system which can be plugged in for immediate operation. Much thought, research and planning would be necessary, and, of course, extensive consultation and negotiation with America's trading partners would be essential.

Conclusions

A fixed currency exchange rate system by means of government agreement and market intervention has appeal for many, especially in Europe. The gold standard is advocated by a growing number of Americans.

Current practice is a floating rate system marked by occasional government interventions and modified by the EMS. There is no

reasonable prospect of a change in present practice in the absence of fundamental changes in government attitudes.

If change is to be made toward either a fixed or gold system, governments must agree to coordinate their fiscal and monetary policies. Even coordination by agreement involves the surrender of some sovereignty over economic policy, and domestic economic and political forces would exert powerful pressures on governments to break the agreements.

Policy coordination by some super-national agency would require even greater loss of sovereignty. Such a system, if desired, may not be impossible to attain. For example, the IMF member countries have given that body authority to maintain "firm surveillance" over their currency exchange systems. It is not yet clear what that means, but if it is not meaningless, it must give the IMF some power over member countries' economic policies.

Since currencies began to float in 1973, world trade has grown in every year but three during a worldwide recession. Growth has resumed in 1984.

During the 1973–84 period, American exports have grown in every year but two, 1982 and 1983. They started to increase again in 1984.

Floating exchange rates, in and of themselves, do not harm world trade and have not impaired the U.S. trade position. It is not whether currencies float but whither.

The forces which have driven up the U.S. dollar exchange value would have existed regardless of the international exchange rate system. Indeed it is quite probable that any attempt at a worldwide fixed rate system during the 1973–84 period would have been overwhelmed by the turmoil of that era and the huge amounts of currencies in nongovernment hands.

APPENDIX 1

REASONS FOR THE STRENGTH OF THE U.S. DOLLAR

There are several reasons and causes for exchange rate fluctuations which apply to the currencies of all major, market-oriented and mixed economy countries. Some of the most important are relative inflation rates, unit labor costs, interest rates, and peoples' expectations as to the changes of those rates and costs in the future. Affecting the U.S. dollar, however, there are other forces to which the other currencies are little, if at all, exposed. These include use of the dollar as a reserve asset, a vehicle currency, and an intervention currency as well as the perception of the United States as a political safe haven.

Reserve Asset

The dollar is the chief reserve asset held by nations' central banks. Gold, SDR's[1] and other hard currencies constitute other parts of countries' reserve assets, but the dollar is the biggest part.

Vehicle Currency

Most of the world's trade is denominated, invoiced, and paid in dollars, and this holds true for trade to which the United States is not a party. The dollar is also the vehicle for much of the world's international investment; tremendous amounts are now being invested in America, and that requires dollars, but much investment elsewhere is also denominated in dollars.

The dollar is the vehicle currency in another extremely important realm of finance. For interbank clearing of well over 90 percent of international payments and currency exchanges, the dollar is in the middle. For example, if a German bank wants to buy sterling with marks, it must first buy dollars with the marks and then buy sterling with the dollars.

Intervention Currency

Governments frequently intervene in foreign exchange markets in order to maintain fixed exchange rates or to influence their currency's value in managed float systems.[2] The dollar is quite commonly used as the intervention currency even though it is not the currency which is target of the intervention. This follows from the dollar's role as the main national reserve asset.

An example could be depreciation of the French franc (Ff) value vis-a-vis the deutsche mark. Both France and Germany are members of the European Monetary System which obliges them to keep their currency values within certain agreed relationships, and France has had to intervene periodically in efforts to keep the Ff at the agreed level. France is quite likely to buy Ffs—thus supporting their value—with part of its dollar reserves.

Safe Haven

Wars, revolutions, military coups, racial and religious conflicts, and terrorism have afflicted numerous countries in Africa, Asia, Europe, the Middle East, and Latin America. Such conditions restrain or prevent economic growth. Sometimes as results of those conditions and sometimes following election of Socialists or other

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[1] SDR's mean Special Drawing Rights. They were created by the International Monetary Fund (IMF) in 1969 to be used by IMF member countries as reserve assets. They are bookkeeping items at IMF and have value because the member countries have agreed upon their value. Each member country was credited with given numbers of SDR's. It was the intention that SDR's would supplant dollars and gold as central reserve assets, but that has occurred to only a limited extent.

[2] See Appendix 2 for discussion of this and related subjects.

parties hostile to private investment, restrictions are placed on private ownership of business or on transfer of money or other assets.

On top of this, it became evident in the early 1980's that many countries could not repay the immense amounts of money they had borrowed during the 1970's. Adverse social and economic repercussions were caused by austerity measures taken to repay. In anticipation of the austerity measures, money poured out of those countries. The bulk of the money which could get out is probably now out of there and in the United States. New money which might otherwise go to the debtor countries is being kept away, and much of it is coming into America.

The United States has remained something of an island of relative security in the midst of troubles and fears of troubles in other countries. It has a huge, open capital market and many other investment opportunities for troubled foreign capital.

All this has created immense demand for dollars bought with other currencies. Although some of the fleeing capital is being put in Switzerland, Canada, Australia, and elsewhere, the great bulk of it came and is coming to the United States.

Continuing Impact of Dollar Strength

Through 1984 the U.S. dollar maintained its strength. Indeed, in December it registered new record highs against the currencies of Britain, France, and Italy; it rose to a 13-year high against the Dutch guilder, more than a 7-year high against the Swiss franc and a 2-year high against the Japanese yen.

Those advances brought the dollar's rise for the year to 14.8 percent against 10 major currencies. On the same basis, it was 76.1 percent higher than it was 5 years earlier.

Thus, the effects of the strong dollar will probably endure and possibly grow in the form of continuing and possibly higher trade deficits for a period of time. That is because trade effects of currency value changes are supposed to lag by 1 to 4 years, so the 1983 and 1984 dollar strength may hamper American exports into 1986 or beyond.

Reasons for the lag of trade effects behind changes in currency value are several. We shall discuss a few; namely, duration of value changes, passthrough, existing contracts, shifting supply sources, and response to incentives.

Duration of Value Changes

Exchange rates fluctuate during every trading day in reaction to supply and demand, political and economic developments. It usually takes some time for exporters, importers, and manufacturers to feel certain a value change will persist rather than reverse after a temporary move.

Passthrough

This refers to how much of the changed relative currency value is passed through to the customer. There are countless potential combinations and results. The simplest to illustrate are complete passthrough or no passthrough. Assume a 10-percent appreciation of the dollar in yen terms and that the Japanese exporter-United States importer contract calls for payment in yen. After the appreciation, the importer's cost would fall 10 percent because 10 percent fewer dollars are needed to buy the same number of yen. The exchange rate appreciation was completely passed through. But if the contract called for payment by the importer in dollars, there would be no passthrough of the appreciation since import costs in dollars would be unchanged.

However, in the real world of export-import there are countless different price and cost change possibilities. After, or in anticipation of, appreciation the exporter might raise its yen prices for an increased yen profit or try for greater market participation with lower prices.

For an American exporter and Japanese importer the problems are the opposite. Prices in yen are 10 percent higher after the dollar appreciation. Depending on the products, the market conditions, and the profit and market share objectives, the exporters and importers might passthrough the full increase, cut prices the full 10 percent or any amount in between. The full burden of price cuts could be borne by the exporter, the importer, or some combination of the two. The importer may seek other sources of the product either in Japan or in other nondollar areas.

Sorting out all those problems (e.g., whether the currency value change will be passed through, if so what part, which parties will reap the benefits or bear the costs and in what proportions) takes time. Thus, the actual trade effects await decisions and actions of manufacturers, exporters, and importers.

Existing Contracts

Frequently there exist extended-time contracts between manufacturers, exporters, and importers, which establish prices and volume. Unless such contracts cover currency value changes, the parties are bound to their terms until they run their course. Such contracts cause delay in adjusting to new currency values.

Shifting Supply Sources

Even though a currency appreciation makes goods priced in that currency more expensive, importers may not switch sources, and, if they do, it can be a time consuming and expensive process. In addition, existing contracts may involve long-standing business and personal relationships which are difficult or painful to break.

Even when purchasers decide to change suppliers, it may take time. It is necessary first to find a satisfactory new source. Unless the new supplier has the product in adequate supply on-the-shelf or can quickly expand production, there will be delays in delivery as new production and transportation are arranged.

Response to Incentives

When the dollar appreciates, American company profit margins from exporting are squeezed. The American exporter may react in several ways. It may cut prices and try to improve productivity in order to guard its export market share. However, unless the American company foresees improvement in export profits, it may not invest in new, improved plant as existing capacity wears out. Or, the company may deemphasize export and concentrate on the domestic market.

Another alternative is to make new or expanded investment in production facilities abroad. These could be in the market country or any foreign location where costs are not in the high-priced dollar. Some feel that this will lead to the deindustrialization of America, at the expense of American exports, and that subject is dealt with briefly below in this appendix.

The point being made at this juncture is, whatever response exporters and importers make to a change in dollar value takes time. Exporters take time after a currency value change to focus their sales efforts on products and markets where they can compete more effectively in old or new markets. This is particularly true of products built to customer specification or which are differentiated by distinctive characteristics for consumer appeal.

DEINDUSTRIALIZATION DUE TO DOLLAR STRENGTH

Some argue that high dollar relative values are causing and will cause American firms to build and expand productive facilities in other countries because they cannot compete by exporting from U.S. plants. They point out there was substantial American investment abroad while the dollar was strong during the 1950's and 1960's.

In addition, there are industries such as steel and automobiles which have failed to invest sufficiently in new, higher technology equipment and to keep down labor and management costs. They have suffered and probably will suffer further displacement by foreign suppliers—some American owned—even when the dollar weakens.

There is evidence, however, that aside from industry specific problems such as those in cars and steel, the United States is not deindustrializing. Since 1970, industrial production in the United States has risen by 41 percent which is more than any other industrial country except Japan where it grew 57 percent. Even since 1980, when the dollar began to appreciate, the industrial production index of the United States is up 7½ percent and is still rising. Manufacturing as a percentage of gross national product has been stable for a number of years. It was 24.5 percent in 1950, 23.3 percent in 1960, 24.1 percent in 1970, 23.8 percent in 1980, 23.1 percent in 1983, and it is estimated to be 23.8 percent in 1984.

It is true that American companies invested heavily around the world during the 1950's and 1960's while the dollar was strong. However, studies have shown the largest reason by far for the investments was to establish and maintain market positions in the host countries, getting behind tariff walls and inside emerging groups such as the European Community. Furthermore, investment and growth were going on at the same time in the United States.

Finally, it was largely as a result of those foreign investments that the United States acquired the assets which generated the dividends, interest, and royalty payments which balanced the American current account BOP. The same people who express concern about deindustrialization foresee the United States becoming a

debtor nation which must pay rather than receive the interest and other payments. One way to avoid or minimize that is for American banks and businesses to purchase foreign assets while they are relatively cheap with the currently strong dollars.

It is true that some businesses are investing in production facilities abroad rather than trying to compete with exports from American plants in face of the strong dollar. Others, however, are slashing costs, improving productivity, and putting more of their budget into research and development to improve their products or produce new ones. On balance, it is probably too early to tell whether there is a net deindustrialization which is at the expense of U.S. exports. The high dollar value is a major factor in decisions both to invest outside the country and to become more productive in the United States.

Export and Other Impacts of a Weakening Dollar

There can be no doubt that currency exchange rates influence the competitiveness of American industry in the world. Since the Bretton Woods and Smithsonian fixed rate systems collapsed in 1973, there have been only two periods of U.S. dollar weakness, and, indeed, during the Bretton Woods era those currency value adjustments permitted by the IMF devalued the other currencies vis-a-vis the dollar.

Through 1973 and into the first quarter of 1975, the dollar moved down; 1975 witnessed the last balance of trade merchandise surplus enjoyed by the United States.

In 1978–80, the dollar reached another low on both trade-weighted and real effective exchange rate bases. The latter takes into consideration not only multinational exchange rate movements, but also the impact of differential inflation rates among the nations whose currencies are included as trading partners. Chart 6 illustrates the dollar exchange rates—American merchandise BOP during the 1973–83 period.

On the weighted average basis, the dollar fell in value by about 14 percent over the 1977–78 period. Following that depreciation of the dollar, American exports accelerated sharply and the merchandise trade balance went from a $21 billion deficit in 1978 to a surplus of $12 billion in 1980. When agricultural and petroleum exports and imports are included in the totals, the amounts are a deficit in 1978 of $34 billion and a lower 1980 deficit of $25 billion.

The study has dealt with the probably lagged trade effects of the current strong dollar. An illustration of the delayed effects of a declining dollar is the so-called J curve.

The J Curve

The theory of the J curve is that the immediate result of a currency devaluation is to exacerbate the currency outflow problem. The devalued currency immediately buys fewer units of other currencies so it requires more units of the devalued currency to pay off existing import contracts. On the export side it takes fewer units of other currencies to pay existing export contracts.

However, products of the country whose currency has been devalued become less expensive in other currencies and more competitive. The country's exporters then sell more of their goods and services to the world.

During the period immediately following devaluation, the balance of trade worsens as old, existing export and import contracts are performed. Money flows out more rapidly which is illustrated by the left arm of the J, going down. Then as all the new orders come in and payments begin and grow, payments even out at the bottom of the J, and, as that process continues, more money is earned through exports than is being paid for imports, and the country's balance of trade goes up the right side of the J into surplus.

Of course, the currency devaluation results are not occurring in a vacuum. Other developments and relationships are extremely important and can prevent or speed up the J curve events. Other things to watch are relative inflation rates as well as different elasticities of supply and demand of exported and imported products.

Elasticities

Demand elasticities are termed high when a relatively small increase (decrease) in price causes a large decrease (increase) in demand for the product. The opposite is low elasticity.

Supply elasticity is termed high when a relatively small increase (decrease) in price results in a large increase (decrease) in supply of the product.

Thus, if the export product enjoyed a high demand elasticity, a small devaluation would result in a large increase of export demand. Things would then be ideal if the supplier also had high supply elasticity.

Other Effects of a Declining Dollar

When the dollar exchange rate goes down, some effects act directly upon exports. Other results follow; they are not unrelated to exports but they warrant separate treatment.

One effect of a falling dollar value will be to increase inflationary pressures. Partly because of a strong dollar, imports have surged into the United States, and the strong dollar has made them less expensive in dollar terms. When the dollar weakens this great volume of imports will be more expensive in dollars and thus inflationary.

Chart 7 illustrates how a strong dollar altered import prices and how much higher they would have been with a weaker dollar.

The higher price imports, resulting from a weaker dollar, in turn lessen the competitive pressures to hold down prices of domestically produced goods. While import growth should slow, that means for a given level of domestic demand there will be a substitution back into domestic production. Lower dollar values draw inflation into the United States, and accelerating growth in domestic production adds to existing pressures on prices. According to an estimate by the Council of Economic Advisers, a 10-percent decline in the dollar value will raise the consumer price level by about three-fourths of 1 percent after 12 months and some 1.5 percent after 2 years.

A lower value dollar and expectations of continuing decline would tend to discourage investments from abroad. Nonresidents would be disinclined to invest in dollar denominated assets when the value of dollars is falling or is expected to fall. Diminished capital inflow results in less available capital for investment and lending and probably higher interest rates which tend to slow economic growth and add to inflation.

The extent to which higher interest rates would reattract foreign capital would depend on nonresidents' perceptions of potential dollar relative strength. If they forecast the dollar would continue to weaken, they would hesitate to buy it for investment purposes even at higher interest rates.

Merchandise Trade and Current Account Balances

Although the focus of this study is American exports, in the interest of balance and completeness, we should examine, at least briefly, U.S. imports and money flows generated other than by imports and exports of goods. In order for nonresidents of America to buy U.S. goods and services—in order for residents to export, the nonresidents must have or acquire dollars. The balance of payments (BOP) figures indicate how many dollars they have acquired and how.

There are two commonly used measures of BOP; they are the merchandise trade balance and the current account balance.

The Merchandise Trade Balance

The is the measure of exports and imports of goods. This balance is in surplus when the exports of goods exceed the imports of goods and in deficit when imports exceed exports. The last year during which the United States achieved a surplus in its merchandise trade was 1975.

The Current Account Balance

This measures the flows of money resulting from merchandise—goods—trade plus money flows in and out of the country to pay for services, earnings on investments (dividends or interest) and unilateral transfers (such as foreign aid or pensions).

Table 2 gives the breakdown of the current account balances from 1976 through 1983. It illustrates the deterioration of the merchandise trade balance and the shrinking surplus of the services and investment accounts.

Chart 8 is a chart of the merchandise BOP and that of the current account. This covers the period 1960 through 1983.

As is evident from Table 2 and Chart 8, much more money is flowing out of the United States than is coming in as a result of goods and services transactions. Comparisons are sometimes drawn between a nation's BOP and a family or private company budget. It is pointed out that a private company or person can spend more than their income for only a limited time. They must draw on their savings or re-

serves which are finite, and/or borrow, and sooner or later they reach their borrowing limit.

For most countries the comparison has some validity although all countries have one power which individuals and companies do not have. Countries can legally print more of their own money. Of course, if the printing presses work too fast, the increased money supply will lead to inflation.

However, the United States is unique among countries, and this has led to a unique role for the dollar. Despite the immense and continuing BOP deficit of the United States, with the attendant outpouring of dollars, the currency remains strong. Reasons for the strength are discussed above.

APPENDIX 2

CURRENCY EXCHANGE EXPLANATIONS AND DEFINITIONS

Currency Values, Fixed or Floating

A nation's currency (e.g., the U.S. dollar (U.S.$) or the German mark (Dm) has value within its country of issue in terms of how many goods and services the U.S.$ will buy in the United States and how many goods and services the Dm will buy in Germany. Some currencies also have value outside their countries of issue, and the value of each currency used outside is determined in the world's international currency exchange markets.

Thus, a holder of U.S.$'s who wished to buy something in Germany would contact currency dealers—frequently large banks—to learn how many U.S.$'s will be required to buy the needed number of Dm. In the May 21, 1984, issue of The Wall Street Journal, the U.S.$ = Dm quotation was 0.3600, or exactly U.S. 0.36¢ for one Dm. Therefore, if the German product cost Dm 1,000,000, U.S.$ 360,000 would be required to buy the Dm 1m.

In the same Journal foreign exchange column, the U.S.$ = Dm quote for the preceding trading day was 0.3652. That indicates the U.S.$ had strengthened in terms of the Dm during the last trading day reported; by the end of the day it cost only U.S. 0.36¢ to buy a Dm while at the end of the preceding day it had cost 0.36 and a fraction U.S. pennies for a Dm. The Dm 1,000,000 at 0.3652 would have cost U.S.$ 365,200, or $5,200 more than a day later. This a good example of the financial results of fluctuating currency exchange rates.

Currency exchange rates will usually fluctuate more if they are permitted to *float* freely than if they are in a *managed float*—sometimes called *dirty float*—or than if they are *fixed* in value in terms of each other. Taking those terms in reverse order, *fixed* exchange rates are fixed in value by agreement between the issuing governments. The governments set the exchange rates, 0.36¢, 75¢, $1.10 or whatever is agreed upon, and they further agree to take whatever steps may be necessary to keep the rates at the agreed ratios, regardless of what the currency markets may do. Thus, if one of the currencies weakens, the governments are obliged to intervene in the markets to buy and strengthen it and maintain its value at the agreed upon, *fixed* rate.

When governments do not have agreements fixing their currencies' values, the foreign exchange markets set the values based upon the supplies and demands for each currency. The currencies are said to be *floating*. Even in the absence of formal agreements, governments usually do not like to see their currencies appreciate or depreciate in value very rapidly or fluctuate violently up and down, so the governments intervene by buying or selling their currencies. This process is referred to as *managed float*. The governments never announce when they will intervene nor with how much money, but intervention is always a possibility. *Managed float* is the usual condition in the present day international currency—foreign exchange—markets.

From time to time governments do not want to intervene in the markets or lack foreign currency or gold reserves and cannot intervene. Then market forces alone determine relative currency values. This condition is referred to as *free float*.

The United States is probably the country which most often expresses reluctance to intervene based on an expressed antipathy toward government intervention in free markets. Other countries, including Canada, Germany, and Mexico, on occasion have ceased support of their currencies and intervention in the markets in order to determine what value the free market would establish for them through *free float*.

Foreign Exchange Markets

Currency exchange markets exist in major cities around the world and are networks of commercial banks, brokers, central banks, businesses, and individuals. They communicate quickly and easily with each other by telephone and telex and can move very large sums of money very quickly in and out of countries.

In aggregate, the foreign currency exchange markets constitute the world's biggest market in terms of money amounts. It is a 24-hour market; as the European markets are closing for the day, the New York market is opening and 3 hours later the American west coast markets open. As they are closing, the Asian markets are opening in Tokyo, Hong Kong, and Singapore. Then the main Middle East market in Bahrain opens and before it closes, Europe is functioning again. A currency buy or sell order can be executed at any time during a 24-hour world business day.

Sizes of Exchange Rate Fluctuations

Whether the U.S.$ is appreciating or depreciating in value frequently depends on which other currency is involved because it sometimes is gaining value in the market with some currencies while losing value relative to others. For example, while the U.S.$ depreciated in value against the Dm and Swiss franc (Sf) during 1980, it appreciated against the Canadian dollar and the Mexican peso.

However, measurements have been devised to determine the overall appreciation or depreciation of the U.S.$ against an average of several currencies. The currency of each country which is an important trading partner of the United States is weighted by its share in U.S. trade. These are called trade-weighted averages, and they are computed by the International Monetary Fund (IMF), the Federal Reserve Board (Fed), and Morgan-Guaranty Trust, among others. Table 3 was prepared by Morgan and shows exchange rates from 1977 through February 1984 between the U.S.$ in the Dm, Y, and Sf plus the trade-weighted average for several time periods.

U.S.$ fluctuations on a trade-weighted average basis are likely to be smaller than when measured against a single other currency. That is because the U.S.$ value is frequently appreciating against some of the currencies in the average while depreciating against others—an example was given above—so that the movements may offset each other.

It should be noted also that U.S.$ fluctuations during relatively brief periods may be greater than the year-to-year changes. In Table 3, the year 1982 shows a 6.2 percent appreciation of the U.S.$ in Dm terms. Within 1982, between the beginning of the year and November 8, the U.S.$ appreciated almost 16 percent; it then dropped nearly 9 percent in value by December 31, 1982.

Reasons for Exchange Rate Fluctuations

There are a number of causes for exchange rate changes. They include relative real income levels, relative interest rates, relative money supply growth, relative current account [1] balances, relative inflation rates, and relative government deficits or surpluses. The relevance of each measurement for currency value changes is how each country compares to the others.

One sort of causation not mentioned but which is extremely important and applies to each named cause is *expectation.* Bankers, exporters, importers, investors, and speculators are constantly alert not only for what is, but also for what they expect will be. When most of them expect a currency to strengthen (or weaken) for any of the named reasons, their purchases (or sales) of that currency can cause self-fulfillment of the expectations.

An example of such purchases and sales and their aftermath was the U.S.$-Mexican peso value change in 1982. Due to relatively high Mexican inflation and BOP deficit, consensus developed by late 1981 that the peso was overvalued and that, sooner or later, the Mexican Government would be unable to keep its value pegged at about 25–1 U.S.$. Businesses and people from the top to the bottom of the Mexican economic scale began to sell pesos and buy dollars. By the summer of 1982, the volume of peso sales overwhelmed the Government's ability to maintain the pegged value, and the peso dropped precipitously before settling at about 150–1. It has been devalued further since then but more slowly.

[1] This refers to the current account of the country's balance of payments (BOP).

TABLES AND CHARTS

TABLE 1.—SHIFTS IN U.S. TRADE BY COUNTRY OR COUNTRY GROUP, 1981–83*

[Dollars in billions]

	1981	1983	Shift
Trade with Mexico:			
U.S. exports	$18.2	$9.1	−$9.1
U.S. imports	−13.8	−16.8	−3.0
Balance	4.4	−7.7	−12.1
Trade with other non-OPEC LDC's:[1]			
U.S. exports	49.7	46.4	−3.3
U.S. imports	−53.1	−60.4	−7.3
Balance	−3.5	−14.1	−10.6
Trade with Japan:			
U.S. exports	21.8	21.7	−0.1
U.S. imports	−37.6	−41.3	−3.7
Balance	−15.8	−19.6	−3.8
Trade with other industrial countries			
U.S. exports	120.1	105.3	−14.8
U.S. imports	−106.7	−113.0	−6.3
Balance	13.4	−7.8	−21.1
Trade with East Europe			
U.S. exports	4.4	2.9	−1.5
U.S. imports	−1.6	−1.4	0.2
Balance	2.9	1.5	−1.3
Trade with OPEC			
U.S. exports	21.1	15.1	−5.9
U.S. imports	−49.9	−25.2	24.7
Balance	−28.8	−10.0	18.8

[1] All data on balance of payments basis, except trade with "other non-OPEC LDC's" which is on roughly comparable Census Customs-value basis.

TABLE 2.—U.S. CURRENT ACCOUNT SINCE 1976, MAJOR COMPONENTS

[Dollars in millions; BOP; seasonally adjusted]

	Merchandise trade balance	Total net investment income	Foreign direct investment income	Other services trade balance	Other [1]	Current account balance
1976	−$9,483	$15,975	$15,889	$2,153	−$4,439	+$4,207
1977	−31,091	17,962	16,839	1,707	−3,089	−14,511
1978	−33,966	20,565	21,247	2,440	−4,485	−15,446
1979	−27,555	31,218	31,973	2,800	−7,427	−964
1980	−24,554	29,570	27,680	5,738	−9,342	+421
1981	−28,067	33,483	24,065	7,462	−8,286	+4,592
1982	−36,389	27,304	18,055	5,727	−7,855	−11,211
1983	−60,596	23,581	15,004	4,790	(2)	−40,776

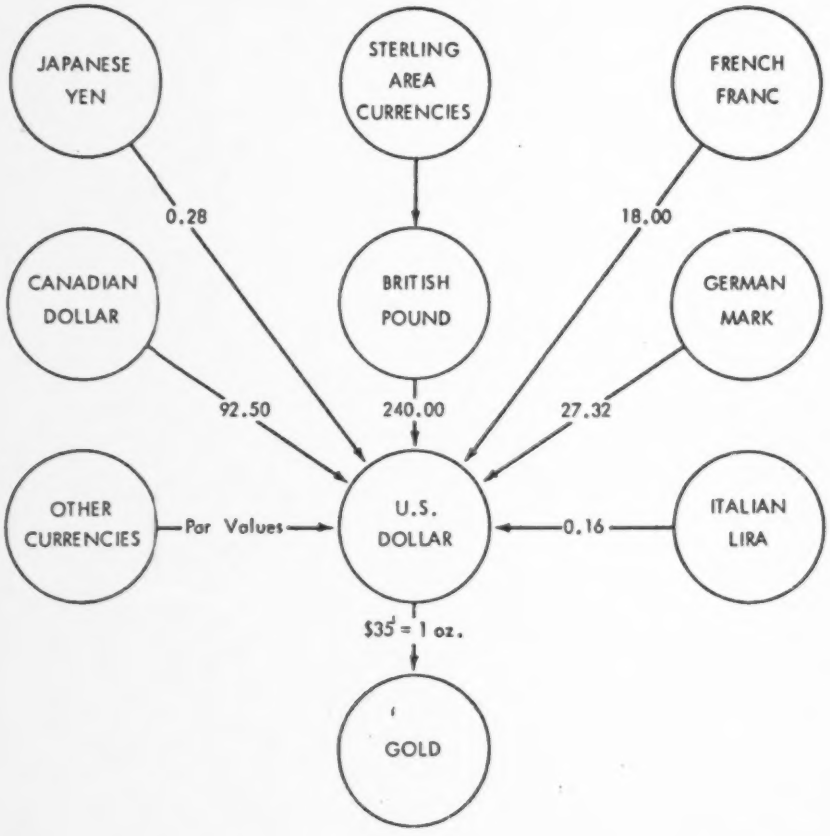
[1] Includes U.S. military agency sales, direct defense expenditures, and unilateral transfers such as foreign aid, U.S. Government pensions, and other official and private transfers and remittances.
[2] Not available.

TABLE 3.—EXCHANGE RATE TRENDS

	Percent depreciation (−) or appreciation in U.S. dollar relative to—			
	DM	Yen	Swiss franc	Trade weighted average
December 31, 1977 to December 31, 1978	−13.4	−19.0	−18.9	−5.0
December 31, 1978 to December 31, 1979	−5.0	23.7	−1.2	2.1
December 31, 1979 to December 31, 1980	14.3	−15.4	11.8	0.7
December 31, 1980 to December 31, 1981	13.8	8.2	0.3	8.6
December 31, 1981 to December 31, 1982	6.2	6.6	12.3	8.6
December 31, 1982 to December 31, 1983	14.2	−1.1	8.7	5.3
December 31, 1983 to December 31, 1984	−5.1	−1.6	−1.3	−2.0

It should be noted that the dollar's fluctuations within years (not shown in the table) are sometimes greater than the year-to-year changes shown in the table. For example, the dollar's appreciation of 6 percent against the DM in 1982 reflects an appreciation of 16 percent between Dec. 31, 1981, and Nov. 8, 1982, and a depreciation of about 8 percent between Nov. 8 and Dec. 31, 1982.

CHART 1.—The central role of the U.S. dollar in the Bretton Woods International Monetary System



Note: Par values as of Aug. 15, 1971, expressed as U.S. cents per currency unit.

CHART 2

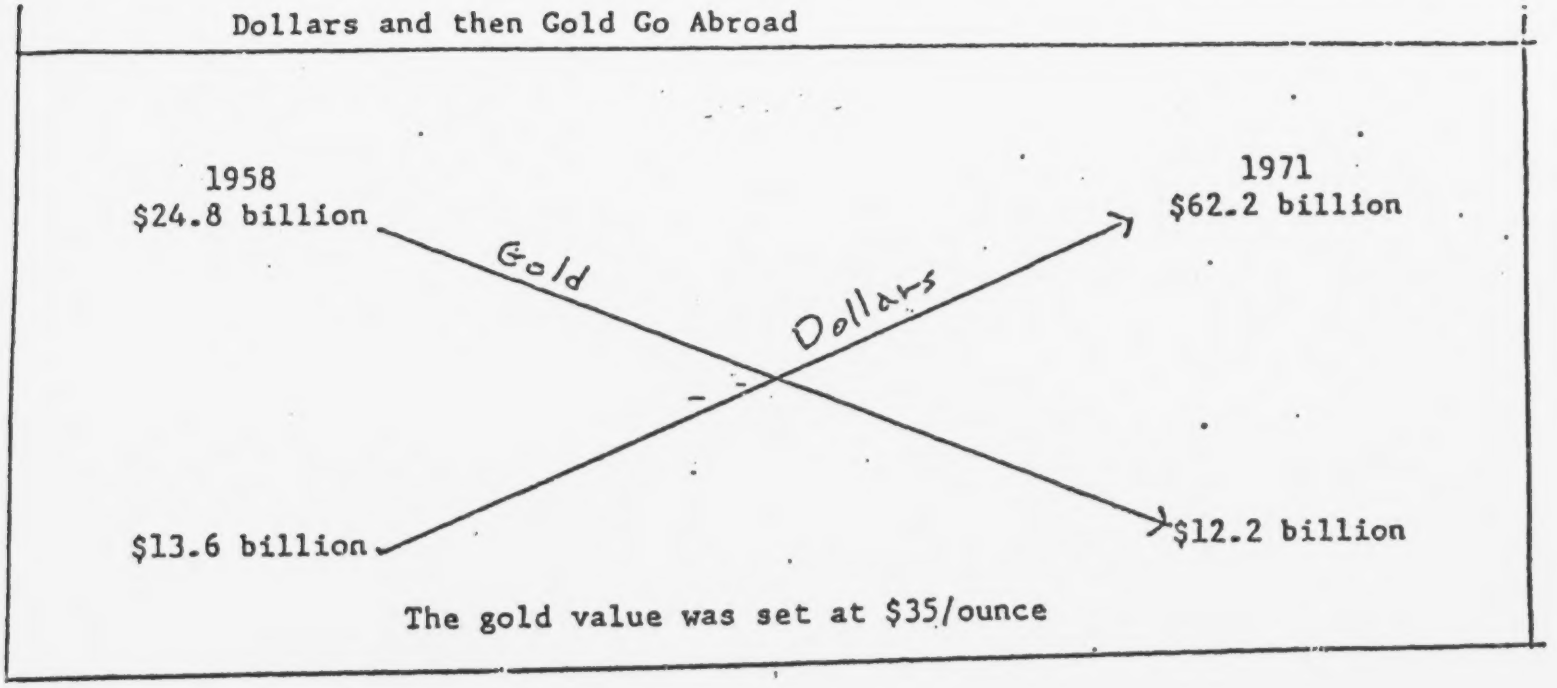
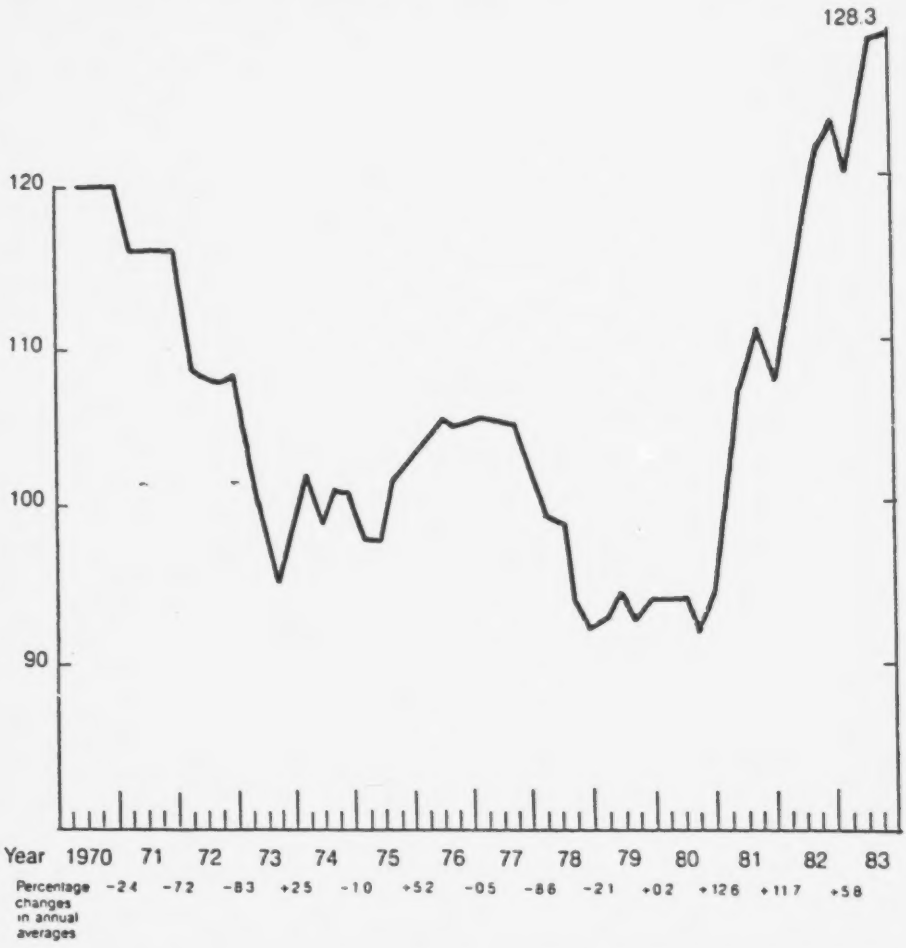
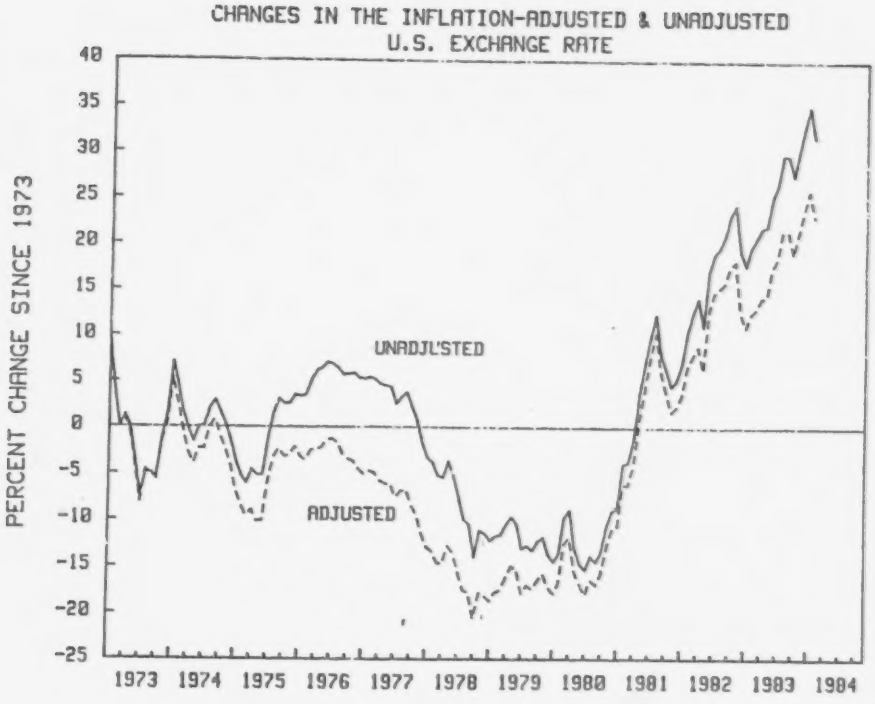

Dollars and then Gold Go Abroad
1958
$24.8 billion
1971
$62.2 billion
Gold
Dollars
$13.6 billion
$12.2 billion
The gold value was set at $35/ounce

CHART 3.—Movements in the dollar exchange rate (plotted from quarterly averages, 1975–100)



Source: IMF, *International Financial Statistics*, various issues: line amx for the United States. Average trade-weighted value of the dollar measured against 17 currencies of the major industrial trading partners.

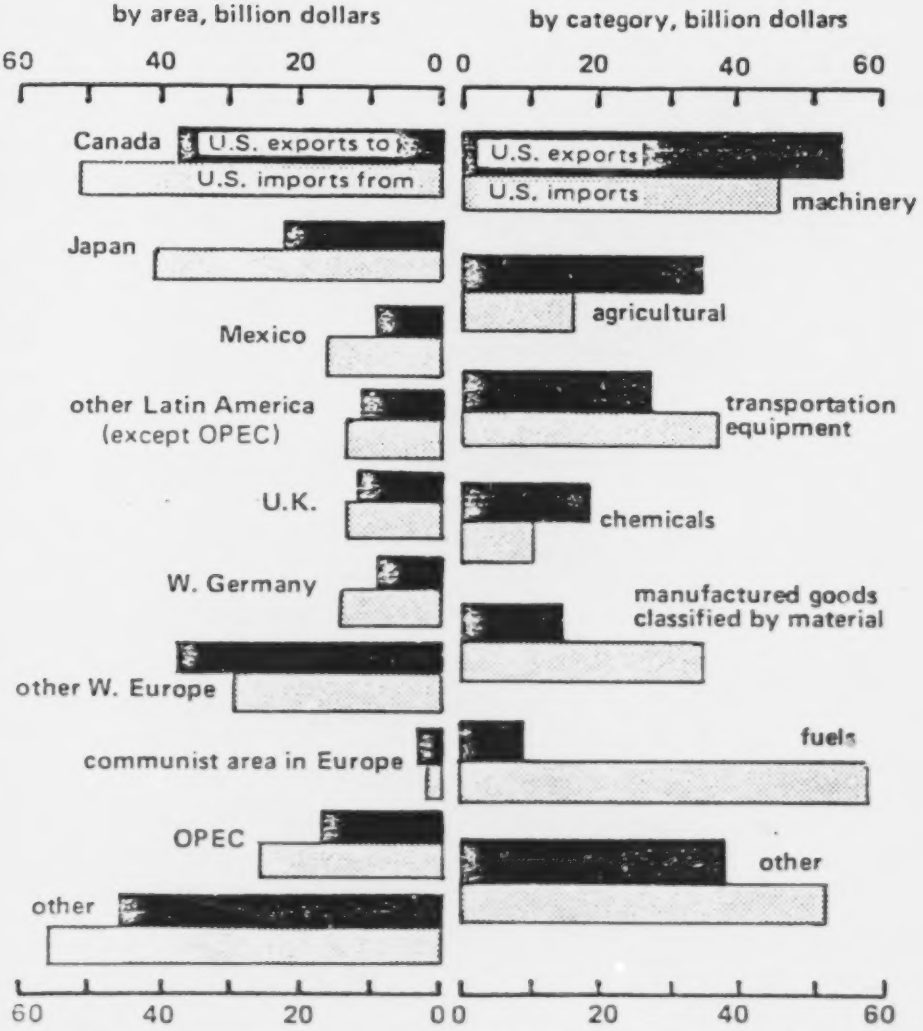
CHART 4



Source: Federal Reserve Board of Governors

CHART 5

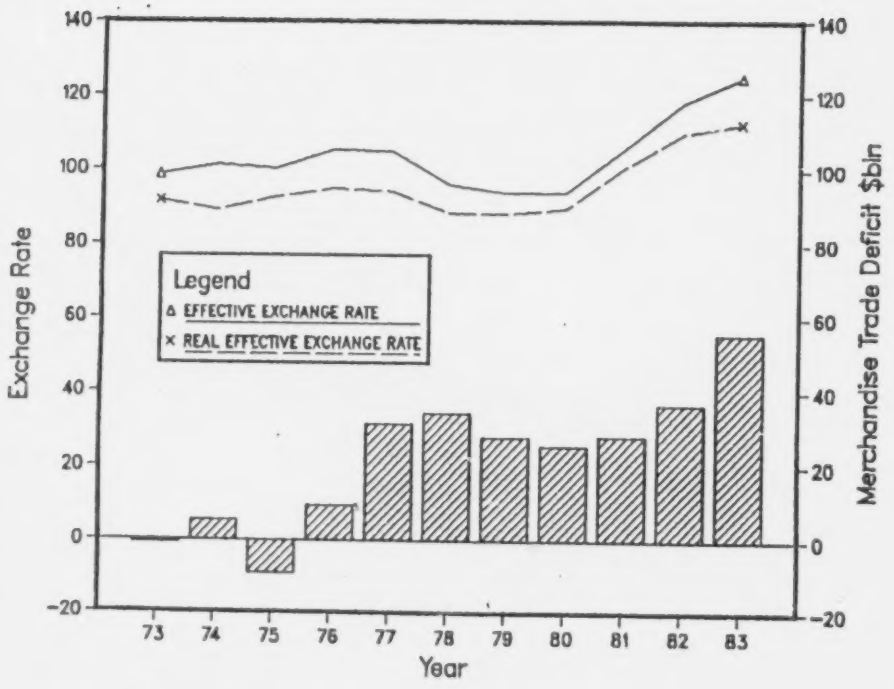
U.S. merchandise trade, 1983*



*Exports are on f.a.s. (free alongside ship, port of exports) basis
Imports are customs value basis.

CHART 6

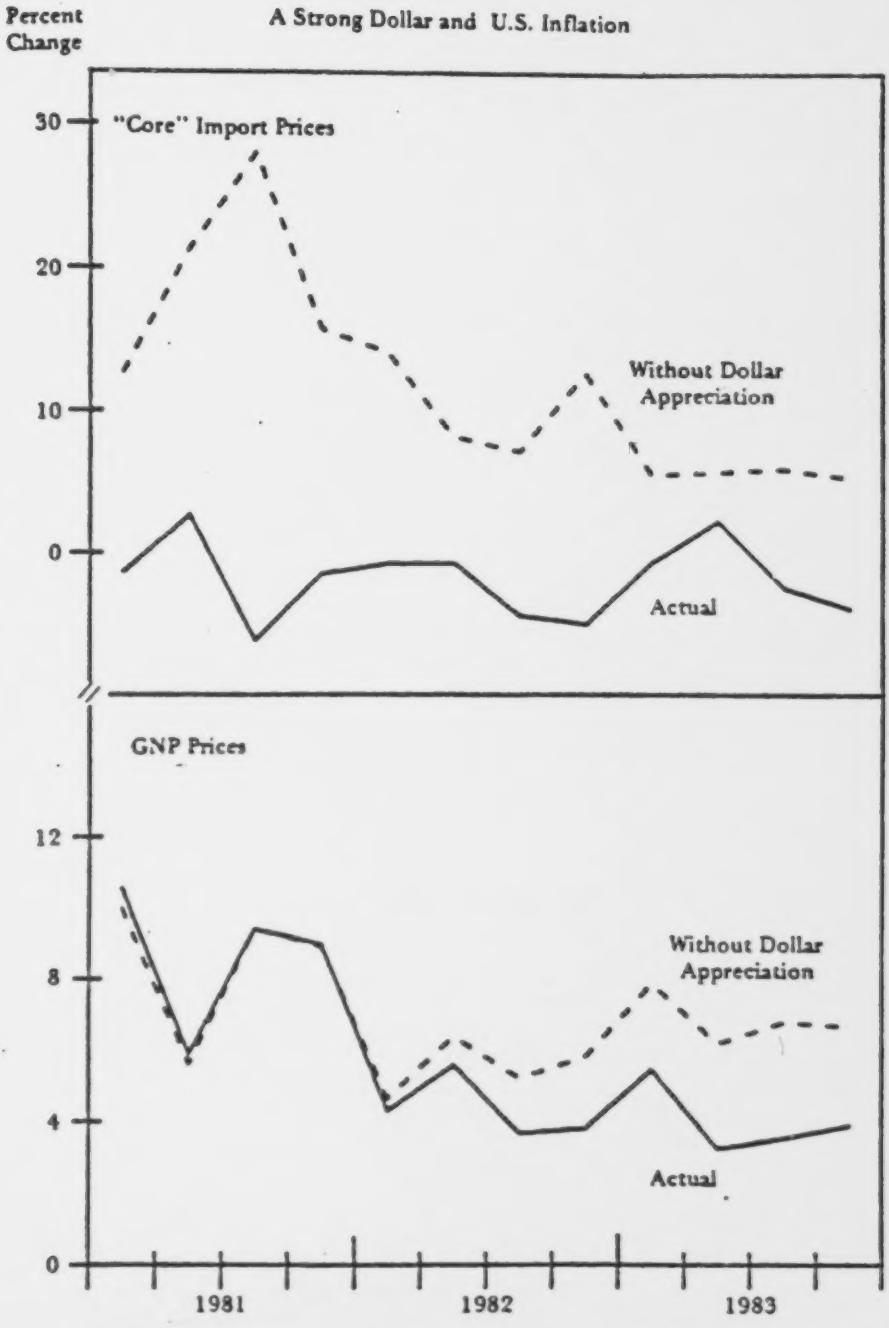
Exchange Rates & Trade Deficit



Δ Base Year = 1975

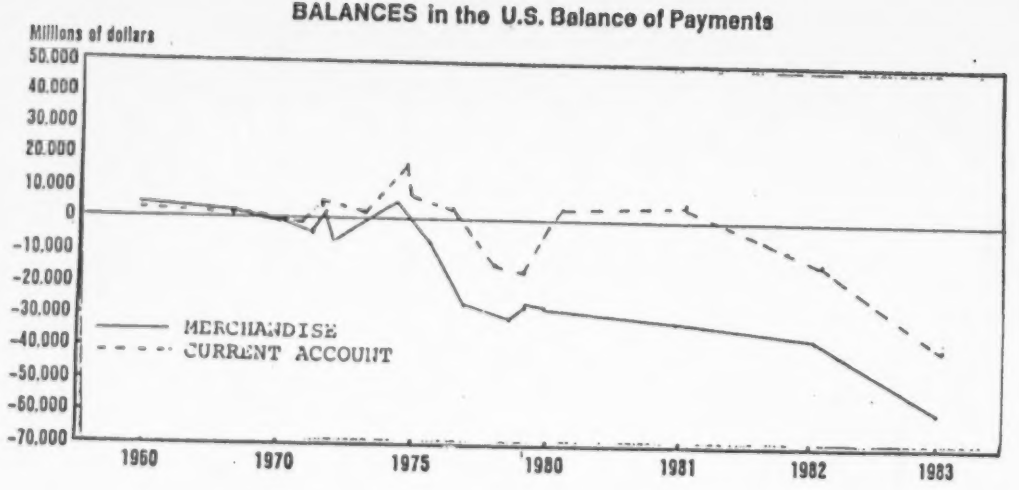
X Base Year = 1980-82

CHART 7



Note: Core import prices were obtained by constructing an implicit deflator for merchandise imports, excluding petroleum, food, and automobiles. The adjustment for dollar appreciation holds the trade-weighted value of the dollar at its 1980-Q3 low; the plotting of this adjusted series is a four-quarter moving average. The adjustment to the GNP implicit price deflator is described in "Reconciling Monetarist with Structuralist Views of Inflation in 1984," Morgan Stanley Economic Perspectives, October 27, 1983.

CHART 8


BALANCES in the U.S. Balance of Payments
Millions of dollars
50.000
40.000
30.000
20.000
10.000
0
-10.000
-20.000
-30.000
-40.000
-50.000
-60.000
-70.000
MERCHANDISE
CURRENT ACCOUNT
1960
1970
1975
1980
1981
1982
1983